

April 26, 2000

The Real Clinton Legacy?

Failed Clinton/Gore Energy Policies Threaten Economy?

Are Clinton/Gore energy policies — or lack thereof — hurting the economy? We know that President Clinton's miscues can affect the stock market. On March 14, 2000, the President inadvertently caused the biotech stocks to fall sharply when he and Prime Minister Tony Blair suggested that the data discovered through gene mapping efforts should be made freely available for research. "Tony Blair and I crashed the markets for a day or two and I didn't mean to," Clinton admitted. Whoops. [Bloomberg News, April 5, 2000]

But does Clinton's influence extend beyond short-term gaffs? Rising energy prices and possible signs of inflation are the headlines today. Perhaps not coincidentally, so are falling markets. The Clinton Administration's failure to address our growing dependence on foreign oil may be just the policy failure that undermines our economy.

Rising Energy Prices

The Clinton/Gore Administration's failure to develop a rational national energy policy has been well documented. Rather than work to make the United States more energy independent while reducing energy costs, the Clinton Administration has taken the opposite tack.

They have opposed expanded exploration for oil and gas, supported tearing down valuable hydroelectric dams in the Pacific Northwest, and supported taxing domestic energy consumption, including enacting an increased federal fuels tax on gasoline, diesel, kerosene, and aviation fuel as part of the 1993 Omnibus Budget Reconciliation Act. [See RPC's "Blame Clinton/Gore for Increased Fuel Prices," 2/28/00]

As a result, our reliance on foreign oil is almost twice the level it was during the oil embargo of the early 1970s. Our increased reliance on oil, in turn, has made us more vulnerable to further supply manipulation by OPEC countries. [See RPC's "Putting Politics First: Clinton/Gore Foreign Policy."] When OPEC slowed the production of oil late last year, the price of oil in the U.S. shot up from \$10 a barrel to over \$30. Many energy experts are predicting additional price spikes this summer.

Oil Price Spikes and Economic Growth

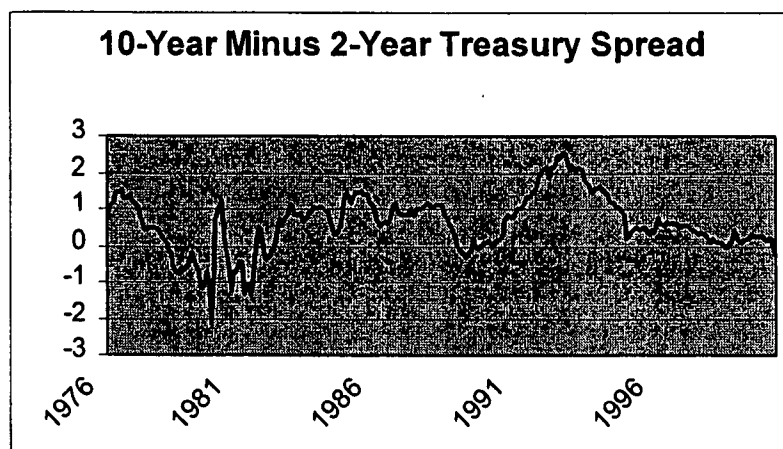
What do sharply rising oil prices mean to the economy? Larry Kudlow, chief economist at CNBC recently tied the two together, observing, "Each of the past three bear market recessions have been associated with sharp oil price increases — 1973-75, 1979-82, and 1989-90."

- In 1974, imported oil prices were 289 percent higher than two years previously. GDP declined by .3 percent that year, and the Dow Jones Industrial declined by 27 percent.
- In 1980, prices were 133 percent higher. GDP growth was zero, and the Dow Jones increased by 15 percent. (Adjusting for inflation, however, reduces investor return to just 2 percent.)
- In 1990, average imported oil prices were 50 percent higher than two years previously, GDP growth was just 1.7 percent, and the Dow dropped by 4 percent.

If oil imports average \$25 dollars a barrel this year, that would represent a 107 percent increase in the last two years. Meanwhile, the Dow is down 4 percent from the beginning of the year.

Rising Interest Rates

Rising oil prices affect more than just energy costs. They are absorbed into a wide variety of goods, causing a general increase in consumer prices. Consumer prices increased .7 percent in March, the largest jump in a year. Even when volatile energy and food prices are removed, the core rate of inflation was .4 percent, the largest increase in five years.



This jump was not lost on the stock markets. The day the new CPI numbers were reported (April 13, 2000) the stock markets suffered record losses. The Dow declined by 616 points, or 6 percent. The Nasdaq lost 356 points, or a remarkable 10 percent of its value.

The price report was not lost on the Federal Reserve either. Alan Greenspan says "first, do no harm," but the Fed may raise the federal funds rate yet again in response to the fuel-driven inflation report. Since June, the Federal Reserve has raised rates five times, from 4.75 to 6.0 percent. The real federal funds rate — the rate minus inflation — is now almost 4 percent, higher than it has been in 10 years. Another rate hike could push the real rate even higher.

These serial rate hikes have raised the rates charged on short-term debt above the rates charged on long-term debt — a so-called inverted yield curve — for the first time since 1989. Not coincidentally, the inverted yield curve of 1989 preceded the last time we had a recession. We also had an inverted yield curve in the late 1970s and early 1980s, which also coincided with an economic downturn.

An inverted yield curve is relatively rare and an indication that something is amiss in the economy. Under normal circumstances, long-term debt should pay higher rates than short-term debt. Experiencing the reverse indicates uncertainty about the economy in the near future.

Conclusion

If a brief statement by President Clinton is enough to slash the value of bio-tech stocks, how much damage can eight years of energy policy neglect inflict? President Clinton's lack of leadership on the energy front is driving up energy prices, driving up inflation numbers, and could drive up interest rates.

Combined, these effects are driving down American wealth. The stock market collapse of April 13, 2000, reduced American wealth by hundreds of billions of dollars. Sustained high energy prices represent an annual loss of between \$50 and \$100 billion from American consumers to foreign oil producers. In the short term, the Clinton/Gore Administration's energy policy failures are costing us money.

What long-term affect they may have is anybody's guess. Granted, the energy sector's share of the economy is half what it was 20 years ago. Moreover, the economy continues to benefit from large productivity increases. Nonetheless, the economy is currently facing a one-two punch of sharp energy price spikes and inverted yield curves that have served as precursors to recessions in the past. The economy may continue to grow, but Clinton/Gore energy policy failures have made us all poorer for the moment.

Written by Brian Reardon, 224-3103